

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 050

June 27, 1958

SALE OR EXCHANGE: RELEASE OF AN OPTION

Syllabus:

From a factual determination, the release of an option was not found to constitute a sale or exchange. Consequently, the consideration for the release was ordinary income.

In December, 1943 taxpayer entered into an "Agreement for Personal Services" with his employer which provided that the employer would employ taxpayer for three years as general manager, and that if the employer received an offer for the business which he desired to accept taxpayer would have 15 days in which to elect to buy the business for 25% less than the offer. In August, 1946 taxpayer agreed to waive his rights under the contract regarding the sale of the business and devote all his time and efforts for the next 90 days to finding a buyer and selling the business. The employer agreed to pay taxpayer \$75,000 if the sale was effected within 90 days. Taxpayer procured a buyer and the sale was consummated in January, 1947, at which time taxpayer received \$70,000. Advice is requested whether this amount was capital gain or ordinary income.

If the \$70,000 was received under the August, 1946 agreement as compensation for services rendered in selling the business, it is clearly ordinary income.

If the payment was made under the 1943 agreement, taxpayer would still realize ordinary income rather than a capital gain as there was no sale or exchange of a capital asset. A sale or exchange involves the transfer of a valuable asset for a consideration. Here, the option was extinguished, not sold or exchanged. The employer did not acquire any valuable asset, but merely obtained a release from her liabilities under the 1943 agreement. The cases on related questions lead to the conclusion that the release by the obligee to the obligor of a contractual relation is not a sale or exchange and the consideration passing to the taxpayer was not capital gain.